No. 304

IN THE

Supreme Court of the United States

OCTOBER TERM, 1953

ELMER F. REMMER, *Petitioner,*

v.

UNITED STATES OF AMERICA

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY BRIEF FOR THE PETITIONER

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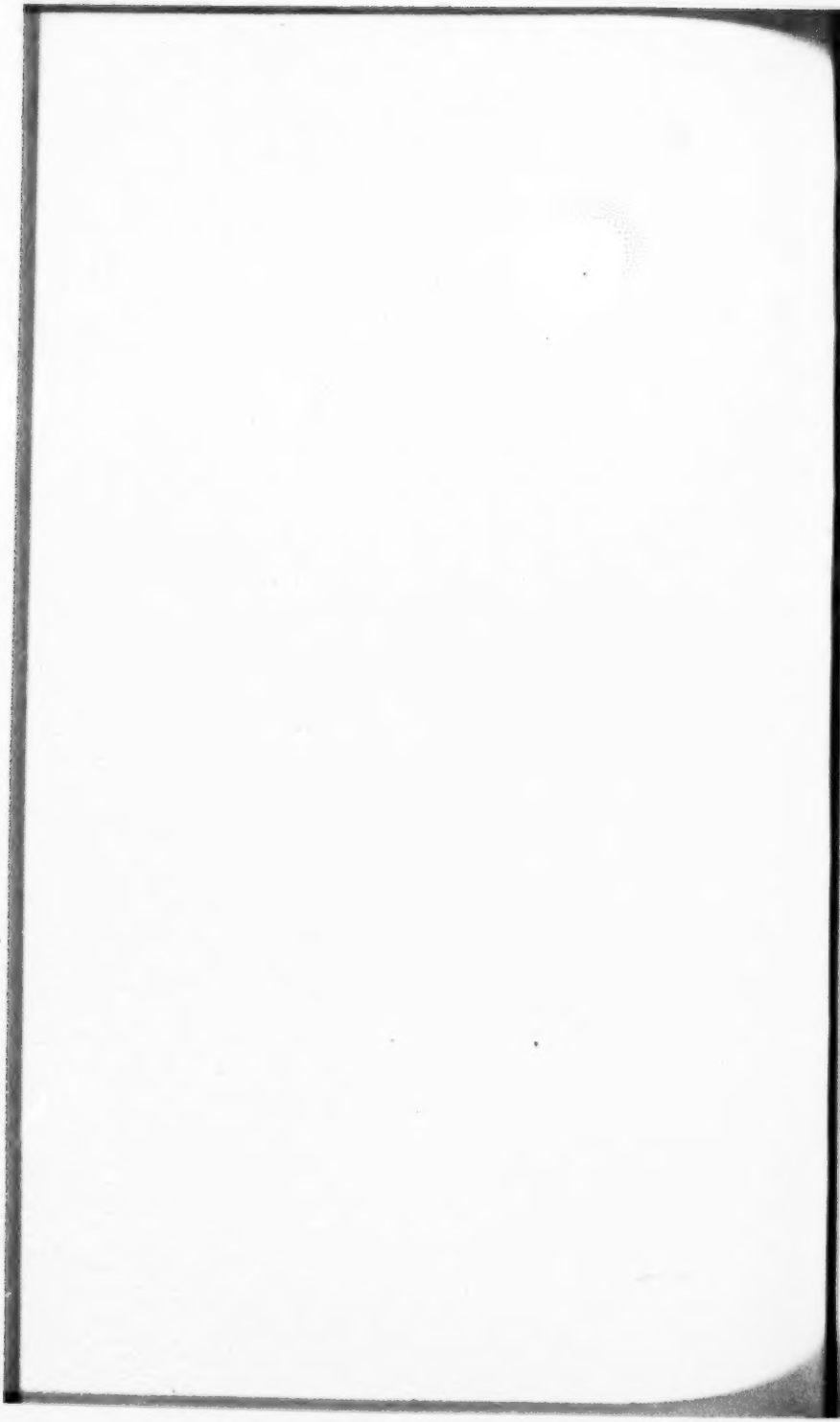

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To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The purpose of this brief is to inform the Court of some recent developments, to comment on the Brief in Opposition and to supply some additional authorities.

ARGUMENT

1. Additional conflicts have arisen with respect to the necessity for establishing the net worth at the beginning of the indictment period (Petition, pp. 17-21).

Although not considering a net worth case at the time, the Third Circuit has added its endorsement to the views on that subject expressed by the Fifth and Seventh Circuits in *Bryan* v. *United States,* 175 F. 2d 223, and *United States* v. *Fenwick,* 177 F. 2d 488.

In *United States* v. *George L. Smith,* 206 F. 2d 905, the court agreed that no conviction could be countenanced where the prosecution failed to establish the net worth at the beginning of the period and added (p. 911):

> We think it part of the Government's prima facie case to establish, at least, that what it charges against defendant is income for the year involved. It has not established its prima facie case by showing that defendant had some money and then asking the jury to infer that that money is "income" for the year involved.

In addition to a conflict between circuits, there is also a difference of opinion among the individual judges of the court below. In *Calderon* v. *United States,* decided October 9, 1953, not yet reported, 53-2 CCH 9579, where the bench consisted of Judges Denman, Healy and Bone, the *Bryan* and *Fenwick* cases were cited with approval. Referring to net-worth statements, the court said:

> Absent such a starting item as, say, cash on hand the remainder of the statement proves nothing.

The Tax Court also has announced its approval of the views of the Fifth and Seventh Circuits and has declined to sustain fraud penalties in a net worth case where the Government's computations failed to take into account cash savings from earlier years. *King Tsak Kwong* v. *Commissioner,* Docket 27019, October 7, 1953, CCH Decision 19,924(M). The Tax Court pointed out that:

> Expenditures and increase in bank balances do not necessarily prove the existence of current income as long as the hypothesis exists that both might have been from sources other than current income.

These recent decisions give added emphasis to the need for the guidance of this Court in order that there may be a uniform understanding and a consistent practice in the application of the judicial process in net-worth cases, which now play so important a part in tax litigation.

Respondent seeks to distinguish the *Bryan* and *Fenwick* cases on the ground that each involved a defective investigation and that the Government was forced to admit that there might well be assets which it had not discovered (B.Op. 24). There is no basis for the suggested distinction.

Here the undisputed evidence showed that there was cash on hand December 31, 1943;[1] the only question was the amount. The Government could not determine it and there was no basis upon which the jury could do better. Accordingly, no reasonable mind could conclude that the amount was insufficient to throw the Government's net-worth computation substantially out of line (B.Op. 22). Respondent's suggestion that the Government's exhaustive investigation, though fruitless, together with petitioner's unwillingness to give assistance, could somehow serve to take the place of the missing evidence, is incompatible with the well-settled principles that the Government has the burden of producing the evidence and that a defendant's failure to testify is without significance. The jury was so charged (R. 132, 152). The net-worth computation conceded the existence of cash and the Government's inability to determine the amount (R. 3613). Thus, this case differs in no substantial respect from the *Bryan* and *Fenwick* cases.

2. With respect to the method of accounting to be employed, the circumstances under which the taxpayer's method may be departed from, and where the authority lies to determine that a departure is necessary (Pet. 21-23), respondent is driven to the contention (fn. 7, B.Op. 25) that Sec. 41, Internal Revenue Code, has no application to criminal cases. The court below held otherwise (R. 3762).

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[1] It was on hand, even if held in storage only overnight (B.Op. 22, fn. 5).

Until the respondent's brief was filed, it had been generally accepted that the Government is forbidden to compute taxable income on any basis other than the method of accounting selected by the taxpayer, unless Section 41 is invoked to authorize a departure. The jury was so charged (R. 136-137). This new construction of Section 41 supports petitioner's contention that the intervention of this Court is required in order that it may be authoritatively determined whether taxpayers are subject to criminal prosecution for failure to report amounts of income disclosed by methods of computation which they did not themselves employ and whose results they could not forsee.

This Court has held that the selection of a method by the taxpayer in his return constitutes an election which binds both him and the Commissioner. *Pacific National Company* v. *Welch*, 304 U.S. 191. The Court further emphasized that the selected method must be adhered to if it is capable of producing correct results. The Court said:

> While petitioner's return may have been an inept application of the deferred payment method, there is nothing in it or the statement of claim for refund that gives any support to the idea that, *if rightly applied*, that method would not clearly reflect income. (Italics supplied)

The Treasury Regulations have adopted a definition of "method of accounting" which, while not wholly consistent with *United States* v. *American Can Company*, 280 U.S. 412 (Pet. 22), nevertheless demonstrates that the courts below erred in approving a departure from the taxpayer's method upon evidence which dealt with the details of bookkeeping rather than the basic method. Treasury Regulations 111, Section 29.41-2, page 254, states:

> A taxpayer who changes the method of accounting employed in keeping his books shall, before computing his income upon such new method for purposes of taxation, secure the consent of the Commissioner. For the purposes of this section, a change in the method of

> accounting employed in keeping books means any change in the accounting treatment of items of income or deductions, such as a change from cash receipts and disbursements method to the accrual method, or vice versa; a change involving the basis of valuation employed in the computation of inventories (see sections 29.22(c)-1 to 29.22(c)-8, inclusive); a change from the cash or accrual method to the long-term contract method, or vice versa; a change in the long-term contract method from the percentage of completion basis to the completed contract basis, or vice versa (see section 29.42-4); or a change involving the adoption of, or a change in the use of, any other specialized basis of computing net income such as the crop basis (see sections 29.22(a)-7 and 29.23(a)-11).

The Court of Appeals for the Sixth Circuit has held that under Sec. 41, Internal Revenue Code, the only question for the courts is whether the Commissioner has abused his discretion. In *Schramm—Receiver of First National Bank, Detroit* v. *United States*, 118 F. 2d 541, the court said:

> This is an administrative problem left by the statute to be determined "in the opinion of the Commissioner", *Lucas* v. *Kansas City Structural Steel Company*, 281 U.S. 264. That official has a broad administrative discretion in determining the question and it is beyond the power of the courts to overturn his decision unless the evidence clearly shows that he has abused his discretion.

This view of the proper application of Sec. 41, Internal Revenue Code, is in sharp contrast with the procedure in the case at bar, where the jury, instead of the Commissioner, was permitted to determine the propriety of departing from the taxpayer's method of accounting by deciding the false issue whether the books were adequate (R. 137). In *Remmer* v. *Commissioner*, Tax Court Docket 23486 (Pet. p. 23, fn. 4) it appears that the Commissioner found no reason to depart from the petitioner's method of accounting. But his subordinates have in effect overruled him by inducing the jury

to reach a contrary conclusion, in disregard of the statutory mandate that the Commissioner's discretion is decisive.

Respondent's reply to petitioner's complaint that it was a travesty of justice to withhold a large quantity of records and then submit to the jury the question whether the records in evidence were adequate (Pet. 33), is that the objection is "patently insubstantial" (B.Op. 26). This casual treatment of an outrageous procedure is not calculated to create public confidence in the administration of justice.

The need for education of the personnel of the Internal Revenue Service (formerly the Bureau of Internal Revenue) in the proper application of the net-worth method of accounting is now officially recognized. The report dated September 25, 1953, of a Hearing Before the Joint Committee on Internal Revenue Taxation on Reorganization of the Internal Revenue Service, contains the following statements by the Commissioner (pp. 17-18):

> Mr. ANDREWS. * * * Now, then, let me tell you, and I am glad you mentioned the net-worth method. In the first place, gentlemen, this method is based upon an accounting technique which is one of the most difficult of all techniques, although to a person experienced in the handling of it, it is really not anything more than a simple procedure. Our difficulty has been—and when I say "our," I mean the service—that the net-worth theory was adopted without, in my opinion, a proper instruction to those who have to apply it, of how to use it.
>
> Representative DINGELL. They said you just count figures and never mind using your brains.
>
> Mr. ANDREWS. We propose to send out a manual to include in our training, which is an up-to-date discourse on how to use the net-worth theory. It is a good technique if it is properly used.

* * * * * * *

(pp. 22-23):

> Mr. ANDREWS. Congressman, let me say this to you: I am not at all happy about the situation as regards the assertion of fraud charges and fraud penalties. There

is, as you know, a distinction between criminal fraud and civil fraud. I am told, and if I am wrong in this distinction Mr. Tuttle can straighten me out, that you assert fraud charges, criminal fraud charges when the preponderance of evidence is enough to give you an indictment before the grand jury. If you assert civil fraud, you do that when there is doubt that you can carry it that far.

Now, I am worried about that last part because I am afraid, very frankly, that there may have been an awful lot of citizens in this country who have been slapped with a civil fraud penalty without complete study.

3. Respondent's reply to petitioner's objection to the inclusion of the markers as cash in Exhibit 183 (Pet. 23-25) is an attempt to show that some undetermined portion was not accounts receivable (B.Op. 28). However, the court below understood that the markers were accounts receivable, and nevertheless held they were properly included as cash items (R. 3769). Since respondent does not attempt to support the use of the hybrid method sanctioned by the court below, it would appear that respondent recognizes the validity of petitioner's assignment of error No. 6, (Pet. 17).

4. With respect to the need for additional detailed instructions to the jury in criminal prosecutions where the offense charged is based upon erroneous interpretation of technical statutory provisions (Petition 26-31), it is pertinent to note that even in civil cases the courts with consistent uniformity have declined to sustain penalties where the liability was unclear or was in doubt at the time of the alleged offenses:

J. B. Jemison v. *Commissioner*, 45 F. 2d 4 (CA 5);
Rogers Recreation Co. of Conn. v. *Commissioner*, 103 F. 2d 780 (CA 2);
Bronson v. *Commissioner*, 183 F. 2d 529 (CA 2);
Wm. E. Mitchell v. *Commissioner*, 45 BTA 822, 118 F. 2d 308 (CA 5);
Kellett v. *Commissioner*, 5 T.C. 608;

Jarvis v. *Commissioner,* Tax Court Docket No. 5126, May 28, 1946, 5 T.C.M. 459;
Kesterson Lumber Corp. v. *Commissioner,* Tax Court Docket No. 127, May 9, 1944, 3 T.C.M. 432;
United States v. *The Bank of Powers, et al,* June 22, 1939, Not officially reported, (DC Ore), 39-2 U.S.T.C. 9665;
Charles C. Rice v. *Commissioner,* 14 T.C. 503;
Joseph H. Imeson v. *Commissioner,* 14 T.C. 1151;
Idus A. Inglis v. *Commissioner,* 14 T.C. 1448;
Dale R. Fulton v. *Commissioner,* 14 T.C. 1453;
Joe H. Bartling v. *Commissioner,* Tax Court Docket Nos. 18905, 19886, June 6, 1950, 9 T.C.M. 458.

To ask a jury to form a rational conclusion with respect to whether petitioner had any basis for claiming his enterprises were partnerships, with only general instructions as a guide (R. 142, 143-144) was to invite a miscarriage of justice. Moreover, it is beyond the capacity of the average jury to pass intelligently on such questions as whether the net-worth method should be used, whether the computation was meaningless in the absence of a firm starting point, or whether the treatment of the markers as cash was permissible. Here the instructions were so general (R. 136-7; R. 147-8; R. 145) that it is doubtful whether the jury even realized that it was supposed to decide these questions.

Respondent does not attempt to support the application of the 1949 rule of *Commissioner* v. *Culbertson,* 337 U.S. 733, in a criminal case involving prior years. The statement (B.Op. 29) that petitioner himself sought the application of the *Culbertson* rule is directly opposed to the Government's brief in the court below, which asserted (pp. 71-72) that the instructions requested by petitioner were properly rejected because they "fail to include the test laid down in that case for determining such fact". The jury did not have the benefit of the concession now made (B.Op. 30) that a failure of the agreement between associates to actually create a partnership status may well be

with no tinge of criminal intent and the court below was persuaded to affirm the conviction on the authority of the *Culbertson* case. Respondent regards the joint conduct of an enterprise under an agreement which is insufficient to create a partnership status as a "nominal partnership" and confuses tax avoidance with tax evasion (B.Op. 30-31).

The Tax Court has recently held that *Commissioner* v. *Culbertson,* 337 U.S. 733, effected such a change in the tax law dealing with partnerships that the court would not recognize an earlier decision as *res judicata. Joe Lynch* v. *Commissioner,* Tax Court Docket No. 24859, 20 T.C. — No. 146, September 23, 1953, CCH Decision 19,901. An excerpt from the Commissioner's brief, quoted in the dissenting opinion, contended that "These cases altered the law governing the validity of family partnerships for tax purposes". The *Lynch* decision emphasizes the uncertain tax status of partnership enterprises, and the validity of petitioner's complaint that he was tried and convicted on the basis of a rule which was not in effect at the time of the alleged offenses. The Government was recognizing the partnerships in a civil proceeding at the same time it sought criminal penalties here (Pet. 27). Thus, the Commissioner's subordinates secured petitioner's conviction for making fraudulent claims, although the Commissioner recognized them as valid. We submit that petitioner is the victim of dubious administrative conduct and that the public interest requires the intervention of this Court.

5. Respondent supports the rulings of the trial court on the motions under Rules 16 and 17 of the Federal Rules of Criminal Procedure on the ground that petitioner's accountant had had ample opportunity to inspect the records and that the last-minute request was unreasonable (B.Op. 32). Thus, respondent assumes that the Government's maneuvering did not contribute to the delay and ignores the fact that petitioner was repeatedly denied access to the records although they were readily available throughout the three months' trial (Pet. 32).

Respondent insists that the trial court has a large measure of discretion (B.Op. 31). In *Fryer* v. *United States*, (CA DC), July 7, 1953, now pending on the Government's petition for certiorari, Docket No. 311, the Government asserts (*Fryer* Pet. 10-11) that the need for limited disclosures is to withhold evidence which may be a surprise and thus prevent perjury, subornation, and an opportunity to manufacture evidence. If that is the purpose of giving the trial court large discretion, it is not apparent why the rule should receive a niggardly construction where, as here, petitioner was seeking records of enterprises which the Government asserted were wholly owned by him.

Respondent's further assertion that petitioner has not been able to show that the rulings were prejudicial (B.Op. 33) disregards the issue of inadequacy of records and the probable affect on the jury of a disclosure that petitioner's books were supplemented by a mass of original documents (Pet. 33).

The principal pertinency of the *Fryer* case here is that the Court of Appeals for the District of Columbia gave to *Bowman Dairy Company* v. *United States*, 341 U.S. 214, a construction which was in marked contrast to the construction adopted by the court below (R. 3757). The court below was guided by the bare decision in the *Bowman* case, while the Court of Appeals for the District of Columbia gave heed to the reasoning of the *Bowman* case. The court below stressed the purpose of the rule to expedite trials, while the Court of Appeals for the District of Columbia was more impressed with the purpose to achieve a fair balance between the Government and the accused so as to bring about fairness in the administration of criminal proceedings. The Government's petition in the *Fryer* case apparently agrees that the latter is the dominant purpose (*Fryer* Pet. 10).

6. With respect to the question of prejudice arising from outside contact with the jury (Pet. 34-37), respondent now contends (B.Op. 34) that there was no proof "that there had in fact been the necessary outside contact with a juror."

This argument does not support the holding of the Court of Appeals to the effect that, assuming the actual contact, there was no showing of prejudice. Unless this Court intervenes, the precedent is established that outside contact is not presumptively prejudicial.

In the court below the fact of actual contact was accepted without question. The Government's brief in the court below stated, page 52:

> Thus, without even making an initial investigation of the facts, appellant, on the basis of pure speculation, was in effect asking the trial judge, who had first-hand knowledge of the events in question, to reconsider his conclusion that they had been "harmless".

It is pertinent to note that a similar question is now pending before this Court in *A. Elwood North* v. *The State of Florida*, No. 435. Here, as in that case, after the verdict petitioner learned for the first time that the jury had been subjected to outside influence. In both cases, the outside influence was of a character calculated to affect the deliberations of the jury. However, unlike the *North* case, no testimony was taken here on petitioner's motion for a new trial and the court below approved denial of the petitioner's motion without any record from which it could determine that no prejudice had occurred. In the *North* case, there was at least a proper judicial inquiry with a reviewable record. Here there was none.

We submit that the pendency of the *North* case is a further cogent reason for the granting of this petition.

7. The constitutional guaranty of due process of law loses much of its substance if the Government prosecutors misinterpret the law and thereby mislead the court and jury in a case dealing with criminal sanctions in the complicated, technical field of the revenue law. *United States* v. *Carroll*, 345 U.S. 457, 460. We submit that it is hopeless to expect the jury, without proper guidance, to comprehend the statutory provisions which are alleged to have been violated.

Both Rule 52(b), Federal Rules of Criminal Procedure, and Rule 27 of this Court, provide that plain errors may be noticed, even though not assigned. Where, as here, the errors affect substantial rights, and present questions of dubious administrative conduct, it is not in the public interest for the court to ignore errors on the ground they were not assigned below, where they are obvious and seriously affect the fairness, integrity or public reputation of judicial proceedings. *Johnson* v. *United States,* 318 U.S. 189; *Simmons* v. *United States,* 206 F. 2d 427 (CA DC).

CONCLUSION

For the foregoing additional reasons, it is respectfully submitted that the petition for a writ of certiorari should be granted.

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November, 1953.

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